

Local Government Group Insurance Fund

**For the Year Ended
June 30, 1997**

Arthur A. Hayes, Jr., CPA
Director

Barbara K. White, CPA
Assistant Director

Lea Ann Boucher, CPA
Audit Manager

Nancy A. Bernstein, CPA
In-Charge Auditor

Blayne Clements
Melissa D. Rice
Jennifer Thomason
Staff Auditors

Dianne Mitchell McKay, CPA
Technical Manager
Erica V. Smith, CPA
Technical Analyst

Leslie Bethea
Editor



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
State Capitol
Nashville, Tennessee 37243-0260
(615) 741-2501

William R. Snodgrass
Comptroller

August 11, 1998

The Honorable Don Sundquist, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
The Honorable John Ferguson, Chairman
Local Government Group Insurance Committee
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Local Government Group Insurance Fund for the year ended June 30, 1997. You will note from the independent auditor's report that an unqualified opinion was given on the fairness of the presentation of the financial statements.

Consideration of internal control over financial reporting and tests of compliance disclosed certain deficiencies, which are detailed in the Observations and Comments section of this report. The Department of Finance and Administration's management has responded to the audit findings. The Division of State Audit will follow up the audit to examine the application of the procedures instituted because of the audit findings.

Very truly yours,

W.R. Snodgrass
Comptroller of the Treasury

WRS/th
98/044

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit
Local Government Group Insurance Fund
For the Year Ended June 30, 1997

AUDIT OBJECTIVES

The objectives of the audit were to consider the fund's internal control over financial reporting; to determine compliance with certain provisions of laws, regulations, and contracts; to determine the fairness of the presentation of the financial statements; and to recommend appropriate actions to correct any deficiencies.

AUDIT FINDINGS

This audit report contains no findings; however, two findings regarding weak computer controls over the Tennessee Insurance System (TIS) were included in the 1997 audit report on the Department of Finance and Administration. The department maintains on TIS participant information such as coverage type and status, eligible dependents, and premiums due and payment history for the Local Government Group Insurance Fund.

OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is unqualified.

"Audit Highlights" is a summary of the audit report. To obtain the complete audit report which contains all findings, recommendations, and management comments, please contact

Comptroller of the Treasury, Division of State Audit
1500 James K. Polk Building, Nashville, TN 37243-0264
(615) 741-3697

Audit Report
Local Government Group Insurance Fund
For the Year Ended June 30, 1997

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Local Government Group Insurance Fund For the Year Ended June 30, 1997

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Local Government Group Insurance Fund. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes the Department of Audit to “perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller.”

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

LEGISLATIVE HISTORY

The Local Government Group Insurance Committee was created in July 1991 by an act of the General Assembly, codified as Title 8, Chapter 27, Section 207, *Tennessee Code Annotated*. The purpose of the committee is to provide a program of health insurance coverage for employees of local governments and quasi-governmental organizations that were established for the primary purpose of providing services for or on behalf of state and local governments.

ORGANIZATION

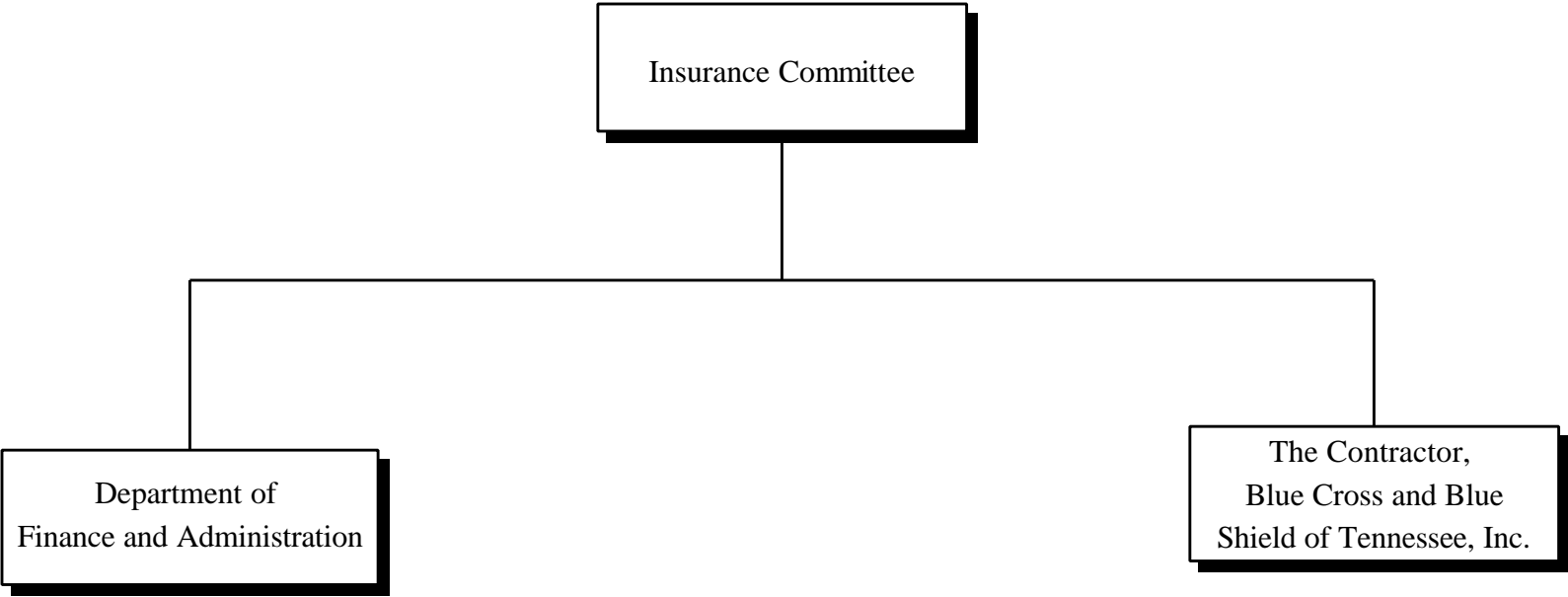
The Local Government Group Insurance Committee oversees the administration of the Local Government Group Insurance Fund. The insurance committee is composed of the Commissioner of Finance and Administration, the Comptroller of the Treasury, the State Treasurer, one representative appointed by the Tennessee Municipal League, and one representative appointed by the Tennessee County Services Association.

The Department of Finance and Administration, Division of Insurance Administration, is responsible for processing all payments and cash receipts of the fund through the state’s accounting system.

The contractor, Blue Cross and Blue Shield of Tennessee, Inc., processes all participant claims, makes all claim payments, provides access to a preferred provider organization, and carries out utilization management functions.

An organization chart of the fund’s administration is on the following page.

LOCAL GOVERNMENT GROUP INSURANCE FUND
ADMINISTRATION
ORGANIZATION CHART



AUDIT SCOPE

The audit was limited to the period July 1, 1996, through June 30, 1997, and was conducted in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Financial statements are presented for the year ended June 30, 1997, and for comparative purposes, the year ended June 30, 1996. The Local Government Group Insurance Fund forms an integral part of state government and as such has been included as an enterprise fund in the *Tennessee Comprehensive Annual Financial Report*.

The audit covered fund 58 of the State of Tennessee Accounting and Reporting System.

OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to consider the fund's internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements;
2. to determine compliance with certain provisions of laws, regulations, and contracts;
3. to determine the fairness of the presentation of the financial statements; and
4. to recommend appropriate actions to correct any deficiencies.

PRIOR AUDIT FINDINGS

There were no findings in the prior audit report; however, the report did refer to a finding in the 1996 audit report on the Department of Finance and Administration concerning weak controls over the Tennessee Insurance System. This finding has not been resolved and is repeated in the 1997 Department of Finance and Administration Audit Report.

OBSERVATIONS AND COMMENTS

The Division of Insurance Administration maintains participant information such as coverage type and status, eligible dependents, employment status, premiums due, and payment history for the Local Government Group Insurance Fund on the Tennessee Insurance System. Two findings regarding computer controls over TIS were included in the 1997 audit report on the Department of Finance and Administration. The Tennessee Insurance System (TIS) has not been designed, implemented, and maintained in a manner which allows it to function efficiently and effectively. As a result, the system is not producing the desired results and changes are made directly to the TIS database through the Application Development Facility (ADF). Because these changes are not made to the insurance accounting on the State of Tennessee Accounting and Reporting System (STARS), TIS and STARS do not reconcile. Management concurred with this finding and stated that the department has reconstructed to focus resources on implementing corrective action.

Second, too many employees have access to security maintenance screens, and security authorization forms identifying approved access to the system were not maintained. Management concurred with this finding, stating that they have taken corrective action.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the Local Government Group Insurance Fund's financial statements for the year ended June 30, 1997, we considered internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements, as required by generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Reportable conditions are detailed in the Observations and Comments section of the report. Consideration of internal control disclosed no material weaknesses.

Compliance

The results of our audit tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Fairness of Financial Statement Presentation

The Division of State Audit has rendered an unqualified opinion on the financial statements of the Local Government Group Insurance Fund.



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 741-3697
FAX (615) 532-2765

**Report on Compliance and on Internal Control Over Financial Reporting
Based on an Audit of Financial Statements
Performed in Accordance With *Government Auditing Standards***

December 17, 1997

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

We have audited the financial statements of the Local Government Group Insurance Fund, as of and for the year ended June 30, 1997, and have issued our report thereon dated December 17, 1997. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the fund's financial statements are free of material misstatement, we performed tests of the fund's compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the fund's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over

The Honorable W. R. Snodgrass
December 17, 1997
Page Two

financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the fund's ability to record, process, summarize, and report financial data consistent with management's assertions in the financial statements.

The following reportable conditions were noted:

- The Tennessee Insurance System has significant problems which have caused TIS and STARS not to reconcile.
- Controls over security for the Tennessee Insurance System should be improved.

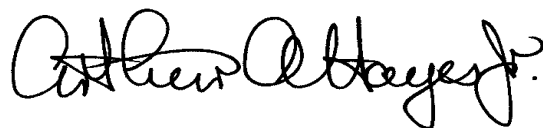
These conditions are described in the Observations and Comments section of this report.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described above are material weaknesses.

We also noted other matters involving the internal control over financial reporting that we have reported to the fund's management in a separate letter.

This report is intended for the information of the General Assembly of the State of Tennessee and management. However, this report is a matter of public record, and its distribution is not limited.

Sincerely,

A handwritten signature in black ink, reading "Arthur A. Hayes, Jr." in a cursive style.

Arthur A. Hayes, Jr., CPA, Director
Division of State Audit

AAH/th



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 741-3697
FAX (615) 532-2765

Independent Auditor's Report

December 17, 1997

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

We have audited the accompanying balance sheets of the Local Government Group Insurance Fund, as of June 30, 1997, and June 30, 1996, and the related statements of revenues, expenses, and changes in retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the fund's management. Our responsibility is to express an opinion on these financial statements, based on our audits.

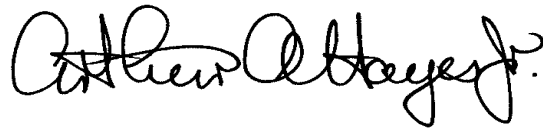
We conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Local Government Group Insurance Fund, as of June 30, 1997, and June 30, 1996, and the results of its operations and cash flows for the years then ended in conformity with generally accepted accounting principles.

The Honorable W. R. Snodgrass
December 17, 1997
Page Two

In accordance with *Government Auditing Standards*, we have also issued our report dated December 17, 1997, on our consideration of the fund's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants.

Sincerely,

A handwritten signature in black ink, reading "Arthur A. Hayes, Jr." with a stylized, cursive script.

Arthur A. Hayes, Jr., CPA, Director
Division of State Audit

AAH/th

LOCAL GOVERNMENT GROUP INSURANCE FUND
COMPARATIVE BALANCE SHEETS
JUNE 30, 1997, AND JUNE 30, 1996

	<u>June 30, 1997</u>	<u>June 30, 1996</u>
(Expressed in Thousands)		
<u>ASSETS</u>		
Current assets:		
Cash (Notes 1 and 2)	\$ 9,747	\$ 10,859
Accounts receivable	511	430
Due from component units	<u>1</u>	<u>-</u>
Total assets	\$ <u>10,259</u>	\$ <u>11,289</u>
<u>LIABILITIES AND EQUITY</u>		
Liabilities:		
Current liabilities:		
Warrants payable	\$ 979	\$ 1,100
Accounts payable and accruals	4,277	5,742
Due to component units	3	4
Deferred revenue	<u>-</u>	<u>26</u>
Total liabilities	<u>5,259</u>	<u>6,872</u>
Equity:		
Retained earnings, unreserved	<u>5,000</u>	<u>4,417</u>
Total equity	<u>5,000</u>	<u>4,417</u>
Total liabilities and equity	\$ <u>10,259</u>	\$ <u>11,289</u>

The Notes to the Financial Statements are an integral part of this statement.

LOCAL GOVERNMENT GROUP INSURANCE FUND
COMPARATIVE STATEMENTS OF REVENUES, EXPENSES, AND
CHANGES IN RETAINED EARNINGS
FOR THE YEARS ENDED JUNE 30, 1997, AND JUNE 30, 1996

	(Expressed in Thousands)	
	Year Ended June 30, 1997	Year Ended June 30, 1996
<u>OPERATING REVENUES</u>		
Premiums	\$ 34,367	\$ 34,205
Total operating revenues	<u>34,367</u>	<u>34,205</u>
<u>OPERATING EXPENSES</u>		
Contractual services	834	706
Rentals and insurance	9,505	4,014
Benefits	23,672	30,138
Other	<u>350</u>	<u>719</u>
Total operating expenses	<u>34,361</u>	<u>35,577</u>
Operating income (loss)	<u>6</u>	<u>(1,372)</u>
<u>NONOPERATING REVENUES</u>		
Interest income	<u>577</u>	<u>652</u>
Total nonoperating revenues	<u>577</u>	<u>652</u>
Net income (loss)	583	(720)
Retained earnings	<u>4,417</u>	<u>5,137</u>
Retained earnings, June 30	\$ <u>5,000</u>	\$ <u>4,417</u>

The Notes to the Financial Statements are an integral part of this statement.

LOCAL GOVERNMENT GROUP INSURANCE FUND
COMPARATIVE STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 1997, AND JUNE 30, 1996

	(Expressed in Thousands)	
	<u>June 30, 1997</u>	<u>June 30, 1996</u>
Cash flows from operating activities:		
Operating income (loss)	\$ <u>6</u>	\$ <u>(1,372)</u>
Adjustments to reconcile operating income (loss) to net cash provided by (used for) operating activities:		
Change in assets and liabilities:		
(Increase) decrease in accounts receivable	(81)	161
Decrease in due from component units	-	4
Increase (decrease) in warrants payable	(122)	917
Decrease in accounts payable	(1,465)	(552)
Increase (decrease) in due to component units	(1)	3
Increase (decrease) in deferred revenue	<u>(26)</u>	<u>3</u>
Total adjustments	<u>(1,695)</u>	<u>536</u>
Net cash used for operating activities	<u>(1,689)</u>	<u>(836)</u>
Cash flows from investing activities:		
Interest received	<u>577</u>	<u>652</u>
Net cash provided by investing activities	<u>577</u>	<u>652</u>
Net decrease in cash	(1,112)	(184)
Cash, July 1	<u>10,859</u>	<u>11,043</u>
Cash, June 30	\$ <u><u>9,747</u></u>	\$ <u><u>10,859</u></u>

The Notes to the Financial Statements are an integral part of this statement.

Local Government Group Insurance Fund
Notes to the Financial Statements
June 30, 1997, and June 30, 1996

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The Local Government Group Insurance Fund is used to account for revenues received and claims paid on behalf of employees of local governments and quasi-governmental organizations established for the primary purpose of providing services for or on behalf of state and local government employees. The fund is part of the primary government and has been included as an enterprise fund in the *Tennessee Comprehensive Annual Financial Report*.

B. Basis of Presentation

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The Local Government Group Insurance Fund follows all applicable GASB pronouncements as well as applicable private-sector pronouncements issued on or before November 30, 1989.

C. Measurement Focus and Basis of Accounting

The accompanying financial statements have been prepared using the accrual basis of accounting and the flow of economic resources measurement focus. Under this basis, revenues are recorded when earned, and expenses are recorded at the time liabilities are incurred.

D. Cash

Cash is defined as cash on hand, demand deposits, such as the pooled investment fund, and investments with three months or less to maturity when purchased.

NOTE 2. DEPOSITS

The Local Government Group Insurance Fund had \$9,747,485 in the State Treasurer's pooled investment fund at June 30, 1997, and \$10,858,705 at June 30, 1996.

Local Government Group Insurance Fund
Notes to the Financial Statements (Cont.)
June 30, 1997, and June 30, 1996

The pooled investment fund administered by the State Treasurer is authorized by statute to invest funds in accordance with policy guidelines approved by the State Funding Board. The current resolution of that board gives the Treasurer approval to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements, various U. S. Treasury and agency obligations, limited money market mutual funds, and obligations of the State of Tennessee pursuant to *Tennessee Code Annotated*, Section 9-4-602(b). The pooled investment fund is also authorized to enter into securities lending agreements in which U. S. government securities may be loaned to brokers for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The pool's custodial credit risk is presented in the *Tennessee Comprehensive Annual Financial Report* for the year ended June 30, 1997.

NOTE 3. RISK MANAGEMENT

The Local Government Group Insurance Fund was established in July 1991 to provide a program of health insurance coverage for employees of local governments and quasi-governmental organizations that were established for the primary purpose of providing services for or on behalf of state and local governments. In accordance with *Tennessee Code Annotated*, Section 8-27-207, all local governments and quasi-governmental organizations described above are eligible to participate. At June 30, 1997, the fund included 10,737 employees and 142 retirees from 243 local governments and quasi-governmental organizations maintaining coverage through the basic plan or a health maintenance organization. The state does not retain any risk for losses by this fund.

The Local Government Group Insurance Fund assumes responsibility for determining plan benefits and eligibility, establishing premiums sufficient to fund plan obligations, recording and reporting financial transactions accurately, reporting enrollment to vendors, processing claims submitted for services provided to plan participants, communicating with plan participants, and complying with appropriate state and federal laws and regulations. Plan participants are required to pay premiums on time, file claims for services received, report changes in eligibility of themselves or their dependents, and ensure that only eligible expenses are paid by the plan. Individuals who cancel coverage may be required to demonstrate insurability to rejoin the plan. Employers must wait 24 months before rejoining the plan if the employer elects to withdraw from the plan. In the case of the individuals or groups rejoining the plan, a preexisting condition exclusion currently applies.

Local Government Group Insurance Fund
Notes to the Financial Statements (Cont.)
June 30, 1997, and June 30, 1996

The Local Government Group Insurance Fund establishes claims liabilities based on estimates of the ultimate cost of claims that have been reported but not settled and of claims that have been incurred but not reported. Employees and providers have 13 months to file medical claims. The process used to compute claims liabilities does not necessarily result in an exact amount. Claims liabilities are recomputed periodically using actuarial and statistical techniques to produce current estimates, which are 17 percent of the prior 12 months' claims. Adjustments to claims liabilities are charged or credited to expense in the period in which they are made. The Local Government Group Insurance Fund does not consider investment income in determining if a premium deficiency exists.

As discussed above, the Local Government Group Insurance Fund establishes a liability for both reported and unreported insured events, which includes estimates of both future payments of losses and related claim adjustment expenses. The following represents changes in those aggregate liabilities since the plan's inception (expressed in thousands):

	<u>1997</u>	<u>1996</u>
Unpaid claims at beginning of year	\$ 5,618	\$ 6,277
Incurred claims, provision for insured events of the current fiscal year	<u>23,673</u>	<u>30,526</u>
Total incurred claims expenses	\$29,291	\$36,803
Payments	<u>25,040</u>	<u>31,185</u>
Total unpaid claims at end of year	<u><u>\$ 4,251</u></u>	<u><u>\$ 5,618</u></u>

STATE OF TENNESSEE
LOCAL GOVERNMENT GROUP INSURANCE FUND
REQUIRED SUPPLEMENTARY INFORMATION
SIX-YEAR CLAIMS DEVELOPMENT INFORMATION

(Expressed in Thousands)

The table below illustrates how the Local Government Group Insurance Fund's earned revenues and investment income compare to related costs of loss and other expenses assumed by the Local Government Group Insurance Fund as of the end of each of the last six years, since the inception of the fund. The rows of the table are defined as follows: (1) This line shows the total of each fiscal year's earned contribution revenues and investment revenues. (2) This line shows each fiscal year's other operating costs of the fund, including overhead. (3) This line shows the fund's incurred claims and allocated claim adjustment expenses (both paid and accrued) as originally reported at the end of the first year in which the event that triggered coverage under the contract occurred. (4) This section shows the cumulative amounts paid as of the end of successive years for each fiscal year; some of these amounts are unavailable. (5) This section shows how each policy year's incurred claims increased or decreased as of the end of successive years; these amounts are unavailable for prior years. This annual reestimation results from new information received on known claims, reevaluation of existing information on known claims, as well as emergence of new claims not previously known. (6) This line compares the latest reestimated incurred claims amount to the amount originally established (line 3) and shows whether this latest estimate of claims cost is greater or less than originally thought. As data for individual fiscal years mature, the correlation between original estimates and reestimated amounts is commonly used to evaluate the accuracy of incurred claims currently recognized in less mature fiscal years. The columns of the table show data for successive fiscal years.

	Fiscal Year Ended					
	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>
(1) Net Earned required contribution and investment revenues	\$21,805	\$30,633	\$41,819	\$40,589	\$34,857	\$34,944
(2) Unallocated expenses	519	621	1,267	852	1,425	1,184
(3) Estimated incurred claims and expense, end of fiscal year	19,752	30,128	41,865	33,483	30,138	23,673
(4) Paid (cumulative) as of:						
End of fiscal year	16,765	*	*	*	*	*
One year later	*	*	*	*	*	
Two years later	*	*	*	*		
Three years later	*	*	*			
Four years later	*	*				
Five years later	*					

(Continued on next page)

	Fiscal Year Ended					
	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>
(5) Reestimated incurred claims and expense:						
End of fiscal year	19,752	30,128	41,865	33,483	30,138	23,673
One year later	*	*	*	*	*	
Two years later	*	*	*	*		
Three years later	*	*	*			
Four years later	*	*				
Five years later	*					
(6) Increase (decrease) in estimated incurred claims and expense from end of fiscal year	*	*	*	*	*	

* Data not available